



## **Circular No. 23** @ 2.1.2007

# **Gibraltar Companies Limited by Guarantee do they fulfill the function of Foundations and Trusts**

### **What is a Company Limited by Guarantee**

The Gibraltar Companies Act does not permit a company to be created in which the members are free from any liability whatsoever, but as an alternative to limiting their contribution to the amount payable for their shares, it enables them to agree that in the event of liquidation they will, if required, subscribe an agreed amount (generally £1 or £5). The Act recognises two forms of company limited by guarantee, namely, the guarantee company without a share capital and the guarantee company with a share capital. The former is the guarantee company in its pure form, whereas the latter is something of a hybrid.

In the case of a pure guarantee company a member is under no obligation to subscribe up to the amount of his guarantee while the company is a going concern; it is only on the company's being wound up if a contribution is needed to enable the debts to be met that any liability on the guarantee arises. But in the case of a guarantee company having a share capital member a is under a twofold liability; while the company is a going concern he is liable to pay up to the nominal amount of his shares, and once the company does into liquidation he is liable on the guarantee as in the case of a pure guarantee company.

### **The Foundation**

Liechtenstein has been marketing foundations since 1927 and foundations account to a large extent for its success as an offshore. For those of us based in a common law area we might well ask what kind of a legal animal is a "foundation"

A foundation consists of a fund dedicated to a given purpose with its own legal personality. Foundations are often devoted to the maintenance, advancement and education of a particular families or persons. The important words to note are **“it’s own legal personality”**.

A trust in common law countries does not have legal personality to the same extent. For example property must be in the name of all the trustee and legal action must be brought in the name of all the trustees.

For clients based in Civil Law jurisdiction the concept of trust is sometimes difficult for them to understand. It can also lead to difficulties with authorities who do not accept the concept of trust.

Gibraltar, however, has its own solution to “Foundations”. The answer lies in the Company Limited by guarantee not having a share capital or a Company Limited by guarantee and having a share capital. These are the equivalent of a Foundation. A body no less well known than the European Union in article 3 of Entities Jurisdique in the Official Journal of the 31st August 1993, No.C236/13 recognised the British Company Limited by Guarantee as the equivalent of the foundation.

This European Union definition opens up a complete new field of business opportunity for Gibraltar as it allows Gibraltar to market “foundations”. Such a development is very welcome as Professionals are looking for a new base for their foundations.

## **F**oundation in Civil Law Countries

Foundations are not a specialty of Liechtenstein, quite contrary to what is often said. Foundations do have a long tradition in the surrounding civil law countries, such as Switzerland and Germany and Austria. They have in these countries been used for centuries for the furtherance of art and charitable purposes and for the furtherance of family purposes.

## **F**oundation Purposes and Functions

Looking at the historic use of foundations and today’s use in particular of Liechtenstein foundations, there are two main important functions, namely (a) they tying-up of family property, and (b) the use of family property for the benefit of family members, such as costs of education and study, and the furtherance and support of family members.

## **Material differences between a Common Law Trust and a Foundation**

The essential element of the foundation is the dedication of property for a specific purpose. The foundation also separates the management and ownership of the property from the beneficial interest.

The trusts is not a legal person while the Foundation has legal personality. The trustee is subject to specific duties and is the legal owner of the property. In some aspects the trust property is considered as a separate patrimoine, namely in connection with creditors of the trustees and the mala fides purchaser or the volunteer to whom trust property has been transferred.

The Liechtenstein foundation because it has legal personality, is subject to the general provisions concerning legal persons and it has a corporate structure with a board of foundation.

Operationally speaking, there is not a great difference between a family foundation and a family trust. They were used in the past and are used today for functions which totally overlap with trust functions. they are used for the following:-

- The tying-up of family property.
- Protection of family property against liabilities vis-à-vis third parties.
- Protection of family members against themselves and against personal creditors.
- Succession into family property outside probate.
- Flexible succession planning.
- Tax planning.
- General asset protection against economic impairment by political events and state intervention.

The similarity in function also exists with respect to a beneficiary under a trust and a beneficiary under a foundation. The beneficiaries of both entities will have the following rights:-

- a) a claim for proper (specific) performance against the trustee in the case of a trust and against the board of foundation where a foundation is concerned. Such a claim lays

when the trust deed is not adhered to or where there is a breach of the foundation articles.

- b) a claim for a benefit from revenue and/or capital within the specific conditions detailed in the trust or foundation.

In summary, one can say that within civil law countries the foundation has developed, whilst in common law countries, the trust has developed, and both institutions have had the same functions and purposes and still do (where they have not been abolished).

### **Analysis of Pros and Cons in the use of Trust and Foundations**

From an operational point of view there are neither pros nor cons in either the use of trust or foundations. They can be administered in a similar way and the duties and powers of the trustee or the board of foundation contain the same fiduciary elements. It is only in borderline situations where the one or the other has a specific advantage or disadvantage. This may be highlighted here.

- a) The foundation is well understood by professionals and clients alike in civil law countries. It is easier to run a family foundation in this context.
- b) Where assets are held in civil law countries it may be safer to use a foundation since the legal personality of a foundation is clearly recognised and there is no doubt about foundation property being separate property as far as creditors are concerned. If trust property is located in such jurisdictions there is a slight danger that under specific circumstances a segregation of such property is not possible.

### **Conclusions**

The conclusions to be drawn are threefold:-

- 1 Foundations and trusts are almost identical and serve the same purposes.
- 2 Careful attention must be given to the drafting of both trusts and foundations.
- 3 Consideration must be given when choosing a trust or a foundation to the legal environment in which the client will operate.

## **The practical difference between a Company Limited by Guarantee Not Having a Share Capital and a Company Limited by Guarantee and Having a Share Capital (The Hybrid Company)**

The origins of “companies limited by guarantee”, and “companies limited by guarantee and having shares” (which we call hybrid companies because of their mixed type of capital), lie in English equity. The first Companies Act in England was essentially building on earlier trust concepts.

When one is considering which of the two types of companies to use one must give serious consideration to the legal environment in which the client will operate. If the clients originate in Liechtenstein or Switzerland one must consider that the idea of a foundation having shares is alien to legal thinking in those countries. Due to this reason mentioned above it may be more prudent, to use a company limited by guarantee not having a share capital for clients originating in Switzerland. The Hybrid company may be more useful where the client has more experience of Common Law or is otherwise more receptive to such a concept.

## **The Company Limited by Guarantee in Gibraltar and how it can function as a Foundation.**

For all intent and purposes a company limited by guarantee is a foundation. When a company limited by guarantee has both a share capital and members who do not contribute to the share capital and, therefore, not shareholders it is known as a **HYBRID COMPANY**. Hybrid companies are rare, since both the United Kingdom and the Republic of Ireland have abolished them, but they exist in Gibraltar and in the Isle of Man as well as in some Caribbean jurisdictions.

Hybrid companies can provide for the shareholders to be a different group of people to the non-shareholder members. Thus the shareholders could be professional trust administrators, in whom could be vested all the voting and administrative powers, while the beneficial owners could be the non-shareholder members in whom would be vested all the rights to income and capital. By this means we have completely divorced control from beneficial interests.

It will often be desirable to build into the Articles of Association provisions for the appointment of some form of protector, whose approval must be obtained for the election of the members, and disposal of assets. The protector should, of course, be an independent third party, with a relationship with the beneficial owners, so that he can

both protect their interest, and also advise the directors when so requested. Where it is inappropriate to appoint a protector as such, it is possible to have a special class of “shares” whose holders exercise the same function as protector.

## **Confidentiality**

Companies limited by Guarantee (foundations) allow for confidentiality without the need for bearer shares. Bearer shares are not allowed in all jurisdiction and can cause administrative difficulties. In a foundation the non-shareholder members still gets his membership certificate if he wants it, but if it is lost or stolen, his membership is unaffected.

## **The evolution of the use of the Foundation**

We have seen described the traditional uses of ‘Foundations’. However, a common practise nowadays is for a “Foundation” to hold a fund not for its members but it holds the funds under its bye laws (trust declaration) for a group of beneficiaries.

Such a use begs the question, why bother with a “Foundation” why not use a simple trust?

The reasons are the following:-

- 1 The “Foundation” has legal personality.
- 2 Each client has his own “Foundation” as opposed to a corporate professional trustee which he may not feel comfortable with.
- 3 The Bye Law (Trust declaration) allows greater flexibility to benefit beneficiaries who may not be members of the “Foundation”
- 4 The fund does not belong to the “Foundation” but is held on trust and, therefore, does not form part of the Foundation’s balance sheet. This makes it simple for the “Foundation” to file accounts, if necessary, under the 4th Directive of the E.U.


- 5 As the “Foundation” holds assets on trust for persons who are non-resident of Gibraltar, such assets are not liable for tax in Gibraltar and, therefore, the “Foundation” does not need to apply for exempt status.
- 6 It allows the fund assets to be transferred to the control of the “Foundation” without having to worry about what method to use to increase the capital of the “Foundation”. The capital of the “Foundation” and the fund it administrates are two separate and distinct matters.

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